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IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA,
Petitioner,

v.

WINSTAR CORPORATION, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF OF FRANKLIN FINANCIAL GROUP, INC.; FRANKLIN FEDERAL SAVINGS BANK; FIRST AMERICAN CORPORATION; C. ROBERT SUESS, LEO C. SHERRY, JR., RICHARD A. GREEN, IRVING ROBERTS AND FOSTER, PAULSELL & BAKER, INC.; LANDMARK LAND COMPANY, INC.; 1ST HOME LIQUIDATING TRUST; FIRST BANK, F.S.B. AND FIRST BANK SYSTEM, INC.; CHARTER ONE BANK, F.S.B.; COMMERCIAL FEDERAL CORPORATION AND COMMERCIAL FEDERAL BANK, F.S.B.; CITIZENS FEDERAL BANK, F.S.B.; AND PERPETUAL FINANCIAL CORPORATION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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Pursuant to Rule 37.3 of the Rules of this Court, *amici curiae* file this brief with the written consent of all parties. The written consent of the Petitioner, United States, and counsels of record for the Respondents, Winstar Corporation, United Federal Savings Bank, Statesman Savings

Holding Corporation, The Statesman Group, Inc., American Life and Casualty Insurance Company and Glendale Federal Bank, F.S.B. have been filed with the Clerk of this Court.

INTEREST OF *AMICI CURIAE*

1. First American Corporation, a Nashville-based bank holding company, acquired Charter Federal Savings Bank ("Charter") on November 30, 1995. Charter, a federal savings and loan association headquartered in Bristol, Virginia, operated in Southwest Virginia and Tennessee from 1920 through the First American acquisition in 1995.

2. Franklin Financial Group, Inc. ("Franklin Financial") is the holding company of Franklin Federal Savings Bank ("Franklin Federal") (previously Morristown Federal Savings & Loan Association), a savings and loan association operating in Morristown, Tennessee since 1935.

3. C. Robert Suess, Leo C. Sherry, Jr., Richard A. Green, Irving Roberts and Foster, Paulsell & Baker, Inc. participate herein on behalf of themselves and the other 6,000 shareholders of Benj. Franklin Federal Savings & Loan Association of Portland, Oregon ("Benj. Franklin"), a savings and loan association that was seized in 1990. The shareholders include many individuals whose life savings were invested as retirement funds in the shares of Benj. Franklin, including hundreds of former employees.

4. Landmark Land Company, Inc. ("Landmark") was initially incorporated in 1865 and became publicly traded in 1919 as an original member of the Curb Exchange (which became the American Stock Exchange).

5. 1st Home Liquidating Trust is the successor to 1st Home Federal Savings and Loan Association of the Carolinas, F.A., whose investors infused more than $30 million in a 1986 thrift recapitalization transaction.

6. First Bank, F.S.B., a federally-chartered stock savings bank, and its wholly-owning parent First Bank System, Inc., are successors by merger to Rocky Mountain Bank, F.S.B. of Cheyenne, Wyoming, a savings bank created in a 1988 thrift recapitalization transaction.

7. Charter One Bank, F.S.B., a wholly-owned subsidiary of Charter One Financial, Inc. and a federally chartered stock savings bank with headquarters in Cleveland, Ohio, acquired a failing thrift in 1982 in exchange for the government's contractual commitment regarding goodwill.

8. Commercial Federal Corporation and its subsidiary Commercial Federal Bank, F.S.B., a federally-chartered savings bank headquartered in Omaha, Nebraska, acquired, *inter alia*, failing thrifts in 1987 and 1988 transactions dependent upon government contract commitments regarding goodwill, preferred stock and a promissory note.

9. Citizens Federal Bank, F.S.B. ("Citizens Federal") is a federally-chartered stock savings and loan association headquartered in Dayton, Ohio. Citizens Federal acquired five failing thrifts during the 1980s in transactions dependent upon government contract commitments regarding goodwill and specific regulatory forbearances.

10. Perpetual Financial Corporation owns all of the stock of Perpetual Savings Bank ("PSB"), which acquired two troubled thrifts in consideration for government contract commitments regarding goodwill.

11. *Amici* have a significant interest in this case because they, like the respondents, have actions pending against the government in the United States Court of Federal Claims seeking, *inter alia*, a remedy for Congress' repudiation of certain government contractual obligations. In all of these cases, the government claims a right to abrogate with impunity bargained-for financial agreements to which it is a party and from which it has received valuable consideration.

SUMMARY OF THE ARGUMENT

1. The irony of this litigation is that the respondents, along with a number of other acquiring thrifts, holding companies and investor groups, have never been part of the savings and loan crisis. Rather, they have been and were recognized by the government to be part of the solution, the so-called "white knights" of the industry. Lacking the funds to save, or alternatively, to liquidate scores of troubled institutions, the government entered into a series of commercial transactions that squarely put the burden of recapitalizing troubled thrifts onto respondents and others similarly situated. However, rather than according these thrifts the contracted-for time in which to eliminate the deficits of the acquired thrifts, Congress repudiated these agreements and mandated instead that these institutions recognize immediately the deficits they inherited, a decision that rendered many institutions insolvent and subject to seizure.

2. The government interprets these contracts as allowing it to reap the substantial consideration provided to it and then to repudiate its obligations under the agreements with impunity, regardless of whether its repudiation leaves the contracting party debilitated, insolvent or even out of business. Nothing in law or equity permits such a perverse result.

ARGUMENT

I. THE GOVERNMENT OFFERED SUPERVISORY GOODWILL TO HEALTHY FINANCIAL INSTITUTIONS TO INDUCE THEM TO ACQUIRE TROUBLED THRIFTS SO THAT THE GOVERNMENT COULD AVOID COSTLY LIQUIDATIONS.

Upon reading the United States' brief, one is left with the inescapable impression that the concept of supervisory goodwill was a scheme developed by lobbyists for the savings and loan industry and foisted upon the United States. The government states in its brief that Members

of Congress, when considering the 1989 legislation that became the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (1989), reached the studied conclusion that supervisory goodwill was merely a "capital gimmick[]," a "shadowy" and "valueless" concept. Brief for Appellants at 4-5 (citations omitted). Such self-serving hyperbole by individual Members of Congress during the height of the political debate on the savings and loan crisis, however, cannot negate the essentially undisputed facts in this litigation: (1) that officials of the Federal Home Loan Bank Board ("FHLBB")—and not lobbyists for savings and loan associations—developed and implemented the concept of supervisory goodwill; (2) that regulators offered supervisory goodwill with the specific purpose of inducing otherwise reluctant investors and healthy institutions to acquire troubled thrifts that the government would otherwise have had to liquidate (but could not afford to liquidate); (3) that the government accepted the substantial benefits these deals accorded it—benefits which included cash, land and other tangible capital investors infused into the troubled thrifts; (4) that having reaped the benefits of the transactions, the government failed to honor its principal obligation under the agreements, *i.e.*, to accord the acquirors the right to treat the resulting goodwill as a regulatory capital asset; and (5) that as a result of the government's breach, many healthy and profitable thrifts were seized while others were significantly damaged.

A. The Federal Home Loan Bank Board, Confronting Its Own Insolvency, Searched For Stable Financial Institutions and Investor Groups.

By the early 1980s, when the federal regulators first introduced the concept of supervisory goodwill, the savings and loan industry was on the verge of collapse. From the late 1970s through the early 1980s, interest rates nationwide were at historic highs, forcing savings

and loan associations to compete for depositors by matching the prevailing rates. But the high interest rates, combined with the significantly lower rate of return savings and loans were receiving on long-term fixed rate mortgages, produced an interest rate mismatch and an avalanche of losses for the industry. In 1981-82 alone, the industry suffered more than $8.9 billion in operating losses. During one 12-month period during this time, more than 80 percent of all Federal Savings and Loan Insurance Corporation ("FSLIC") insured thrifts had incurred operating losses. 1985 FHLBB ANN. REP. 5-6.

During this same time period, the FSLIC, the agency charged by Congress since 1934 with providing deposit insurance for depositors of savings and loans nationwide, was depleting its reserves and facing bankruptcy, having expended billions of dollars to assist struggling thrifts while compensating insured depositors of failed thrifts. In 1980, the FSLIC maintained about $6.5 billion in reserves; by 1986, the agency ran a deficit of more than $6 billion, and the deficit was growing. 1986 FHLBB ANN. REP. 15, 25; *Financial Audit: Federal Savings and Loan Insurance Corporation's 1987 and 1986 Financial Statements*, GEN. ACCT. OFF. REP. at 13 (July 1988).

Without sufficient funds to liquidate failing thrifts and to pay the depositors, the FHLBB, together with the FSLIC, sought to develop and implement a policy of encouraging strong and healthy institutions to acquire ailing savings associations. Such a policy would render the acquiring institution responsible for eliminating the troubled thrifts' negative net worth for which the government would otherwise have been responsible. *See Charter Fed. Sav. Bank v. Office of Thrift Supervision*, 976 F.2d 203, 204-05 (4th Cir. 1992), *cert. denied*, 507 U.S. 1004 (1993).

The agencies initially offered cash incentives to purchasing institutions to encourage the acquisition of troubled thrifts and to minimize government pay-outs. *Id.*

While the cost of arranging these mergers was high, doing so preserved funds that otherwise would have been spent liquidating the failing thrifts. In fact, FSLIC-assisted mergers have "[h]istorically . . . cost about 70% of [the] cost of liquidation," thereby saving the government many millions of dollars. Remarks by H. Brent Beasley, Director of FSLIC, Before the California Savings and Loan League Management Conference (Sept. 9, 1982).

The FHLBB and FSLIC, however, soon recognized that the policy of providing cash contributions was only contributing to the depletion of the insurance fund. Because the agencies no longer could provide cash or other tangible financial incentives, the government began encouraging supervisory mergers and acquisitions by promising other, less costly, forms of assistance. *See Olympic Fed. Sav. & Loan Ass'n v. Office of Thrift Supervision*, 732 F. Supp. 1183, 1185 (D.D.C. 1990). The primary form of assistance was to allow an acquiring institution to treat the inherited deficit net worth as an intangible asset, called supervisory goodwill, to be amortized over an agreed-upon period of time. The offer of supervisory goodwill was vital to the government's efforts to encourage healthy thrifts to assume the liabilities of weaker institutions.

Richard T. Pratt, Chairman of the FHLBB from 1981 to 1983, in a statement before the United States House of Representatives, Committee on Banking, Finance and Urban Affairs, acknowledged the importance of supervisory goodwill:

> The Bank Board was caught between a rock and a hard place. While it did not have sufficient resources to close all insolvent institutions, at the same time, it had to consolidate the industry, move weaker institutions into stronger hands, and do everything possible to minimize losses during the transition period. *Goodwill was an indispensable tool in performing this task.* [Goodwill] provided a bridge which al-

> lowed the Bank Board to encourage the necessary consolidation of the industry, while at the same time husbanding the financial resources which were then available to it.

Savings & Loan Policies in the Late 1970's & 1980's: Hearings Before the House Comm. on Banking, Fin. & Urban Affairs, 101st Cong., 2d Sess. 227 (1990) (emphasis added). Thurman Connell, the former Senior Vice President of Supervision of the Atlanta Federal Home Loan Bank ("FHLB-Atlanta"), also testified that the offer of supervisory goodwill to acquiring institutions and investor groups was the linchpin of the government's efforts to rescue a struggling industry:

> [W]e were faced with an up hill [sic] battle of literally hundreds and possibly thousands of S&Ls running out of net worth. And [treating supervisory goodwill as an asset] was an alternative to being forced at that time to deal with all of those failures, because at that time the financial resources were not available to solve them in the way that the FSLIC had been able to solve cases in earlier years.
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> * * * *
>
> [T]here was an effort made to find [a] means of being able to assist the industry in getting through this very difficult time, because as it stood, if interest rates did not change dramatically, *the possibility existed that the industry could entirely fail at that time*. . . . And one of the considerations that came up was the ability to use goodwill and to be able to incenticize [sic] healthy institutions that had a longer projected longevity to come in and take them over and to be able to stretch out, you know, the accounting for the goodwill.

Deposition of Thurman Connell (the relevant excerpts may be found in the Joint Appendix in the appeal of *Charter Fed. Sav. Bank v. OTS*, 976 F.2d 203 (4th Cir. 1992) at 243-44) ("*Charter* J.A."). Mr. Connell was unequivocal in his view that the regulators considered

the new treatment of supervisory goodwill as "a very important aspect of [the acquiring thrifts'] willingness to enter into these agreements." *Id.* at 224. The regulators, Mr. Connell concluded, "looked at [supervisory goodwill] as kind of the engine that made this transaction go. Because without it, there wouldn't have been any train pulling out of the station, so to speak." *Id.*

While the government now seeks to paint those thrifts and investment groups who contracted with the government as being part of the problem, and even a cause of the crisis, it was the government that turned to these groups to save the industry.

B. Charter Acquired Four Troubled Thrifts After Considerable Negotiations.

In June 1981, the government deemed Charter a viable and financially strong institution. The institution had a positive net worth and consistently satisfied every state and federal regulatory capital requirement in its history. In light of the institution's financial stability, the government from 1981 through 1985 repeatedly asked Charter to acquire troubled savings associations. In each instance, the government recognized that if it were unsuccessful in finding a merger partner, the troubled thrift would have to be liquidated at a cost to the FSLIC insurance fund of millions of dollars.

The government's first attempt to merge a troubled thrift with Charter came in mid-1981. Supervisory agents of the FHLB-Atlanta contacted Charter in an effort to persuade Charter to acquire First Federal Savings & Loan Association of New River Valley ("New River"). The market value of New River's liabilities exceeded the market value of its assets by approximately $13.5 million. Recognizing that it could not absorb New River's $13.5 million deficit net worth and remain in compliance with

the regulatory capital requirements, Charter declined the government's invitation to pursue the merger.

A few months later, supervisory agents again solicited the assistance of Charter. This time the FHLB-Atlanta asked Charter to acquire not only New River, but also Peoples Federal Savings and Loan Association ("Peoples"). The combined deficit net worth of these institutions exceeded $47.1 million.

Recognizing that Charter had once before turned down an opportunity to merge with a failing thrift, the government needed to provide Charter with an incentive to consummate the mergers. The government also knew that immediate recognition of the failing thrifts' combined deficit would leave Charter in noncompliance with the applicable capital requirements, thereby rendering the institution vulnerable to a government takeover. Lacking funds to offer Charter cash or other tangible assistance, the government opted to offer the institution *intangible* assistance. Specifically, the government agreed to permit Charter to use the "purchase method of accounting" provided for by Generally Accepted Accounting Principles ("GAAP") for purposes of determining the institution's compliance with regulatory capital requirements. Under the purchase method of accounting, the government agreed that Charter could treat the amount by which the market value of New River's and Peoples' liability exceeded the market value of their assets as supervisory goodwill, which could then be amortized over 40 years. This treatment of supervisory goodwill allowed Charter the right to forego recognizing immediately the inherited deficit net worth, instead according the institution time to eliminate the deficit through profits.

In 1985, the Cincinnati supervisory agents again approached Charter, this time in an effort to persuade Charter to acquire New Federal Savings and Loan ("New Federal"). The FSLIC created New Federal on November 16, 1984 by transferring the insured deposits from five failed savings and loan associations located in Tennessee to New Federal to provide depositors access to their deposits. From the time of New Federal's inception, a receiver appointed by FSLIC managed New Federal, whose liabilities exceeded the market value of its assets by approximately $15 million. Charter and the FSLIC eventually agreed to an acquisition similar to the 1982 transaction; that is, Charter was given the right to treat the resulting supervisory goodwill as a regulatory capital asset that could be amortized over a number of years.

Charter's final acquisition was consummated in June 1985, at which time Charter again answered the government's request for assistance and consented to acquire yet another insolvent thrift, Magnolia Federal Savings and Loan Association ("Magnolia"), which had been in receivership since June 7, 1985. As in each of the prior supervisory acquisitions, the ability to treat supervisory goodwill as an asset was an essential term of the agreement, without which Charter would not, and indeed could not, have consented to the acquisition.

In each of the above transactions, it was the government, and not Charter, that initiated the acquisitions. In each case, Charter fully satisfied its obligation of assuming the considerable deficit net worth of the respective institutions. Charter saved the federal government well in excess of $60 million that would otherwise have gone to cover insured depositors at these institutions. All Charter asked for, and was promised in return, was the right to treat the resulting supervisory goodwill as an asset for regulatory capital purposes to be amortized over a period of time.

Thurman Connell, who was the FHLB-Atlanta official approving Charter's mergers, testified that Charter's acquisitions gave rise to binding contractual obligations:

> Here we had an S&L that had agreed to take on a troubled thrift, but as really an incentive or prerequisite to their doing this, . . . they had to have the ability to recognize the goodwill over a period of time. . . . The Bank Board approved it and we had an agreement at that time. . . .
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> * * * *
>
> [A]t that time it became something that you no longer could change; . . . it was an understanding, an agreement between the parties, and the Bank Board had accepted it and they were willing to be bound by the terms that they had agreed to.

Charter J.A. at 230.

Over the years, Charter proved its ability to increase its tangible net worth. While the acquisitions caused Charter's tangible net worth to decline by over $60 million, the institution was able largely to offset this amount by earning almost $50 million from 1982 through the passage of FIRREA in 1989. After staving off an attempt by regulators to appoint a conservator for the institution following the enactment of FIRREA, Charter raised the necessary capital to bring it into full capital compliance. Then, in 1995, First American acquired Charter.

C. Franklin Financial Acquired Morristown FS&LA After Considerable Negotiations.

In late 1988, the government was faced with the prospect of seizing a small, hometown thrift, Morristown Federal Savings & Loan Association ("Morristown FS&LA"), with offices in Morristown, Jefferson City and Newport, Tennessee. The thrift, which served the credit needs of local businesses and families in Morristown, Tennessee since 1935, suffered operating losses from 1983 through 1987 and amassed a negative net worth of $9.6 million. Had federal regulators appointed a receiver for Morristown FS&LA, the government would have had to spend

about $10 million to pay off the insured depositors, and such appointment would have simultaneously eliminated an important source of jobs and credit for the small community of which the thrift was a vital part.

Consistent with its policy of seeking private investor groups and other healthy institutions to acquire troubled institutions, the FHLBB turned to a group of local community leaders in the hope that they might agree to purchase Morristown FS&LA and permit the FSLIC to avoid another costly bailout. A group of seven Morristown citizens formed Franklin Financial. After months of negotiating with the FHLBB, Franklin Financial, on January 12, 1989, acquired Morristown FS&LA.

As part of its agreement with the government, Franklin Financial invested $5 million into the institution, which was renamed Franklin Federal Savings Bank. The parties agreed that this infusion would be more than sufficient to meet the capital needs of the institution. To obtain the $5 million, the Franklin Financial shareholders borrowed a significant amount of money from an unrelated commercial bank lender. The lender relied upon the credit of the shareholders and therefore did not require Franklin Federal to pledge its securities or assets. Rather, *the borrowing was secured by collateral belonging solely to the shareholders and their personal guarantees.* The shareholders intended that the debt would be serviced, in large part, by the dividends distributed by the institution. The shareholders also agreed that they personally would be responsible for any deficient payment of dividends based upon their respective pro rata interest in the holding company.

The parties memorialized their agreement in the Voting and Disposition Rights/Dividend Agreement ("Dividend Agreement"), signed and executed by the FSLIC and Franklin Financial. The Dividend Agreement provided that "[t]his Agreement, together with any understanding

agreed to in writing by the parties, supersedes all prior agreements and understandings of the parties in connection with the subject matter hereof." Article X.K. The parties further stipulated that "[t]his Agreement shall be deemed a contract made under and governed by Federal law." Article VIII.B.-C.

One of the writings drafted contemporaneously with and incorporated as part of the Dividend Agreement was a Forbearance Letter provided to Franklin Financial from the FHLBB. The Forbearance Letter stated:

> 1. For purposes of reporting to the Board, the value of any unidentifiable intangible assets resulting from accounting for the acquisition in accordance with the purchase method may be amortized by Franklin Federal Savings Bank over a period not to exceed 25 years by the straight line method.

The FHLBB thereafter waived all regulations and statutes that may conflict with the agreed-upon accounting treatment of the acquisition:

> This letter does not and shall not be construed to constitute forbearance or waiver by the Board or the FSLIC with respect to any regulatory or other requirements *other than those encompassed within the preceding paragraph 1*.

(Emphasis added.)

The Forbearance Letter, specifically negotiated, formed the heart of the deal. Both parties recognized that without the forbearance the undercapitalized institution would have been vulnerable to a government takeover the moment the deal was consummated. Thus, absent the forbearance, the shareholders of Franklin Financial would not have agreed to acquire the institution or to invest $5 million of their own money into the institution. Use of the purchase method of accounting, together with the

forbearance of conflicting statutory and regulatory requirements, however, permitted the new owners to invest their funds with the guarantee that they would be accorded the necessary time to eliminate the deficit that they inherited at the government's request.

Franklin Federal transformed its predecessor into a profitable institution. While Morristown FS&LA lost on average more than $200,000 annually from 1983 through 1988, Franklin Federal increased its tangible net worth every quarter since the transaction. The institution is now fully capitalized and satisfies every regulatory capital requirement.

Franklin Federal, however, almost was not afforded the chance to succeed. Eight months after Franklin Financial and the government executed the Dividend Agreement, Congress enacted FIRREA, and the regulators threatened Franklin Federal with seizure. Franklin Federal staved off seizure, first by obtaining an injunction prohibiting the government from seizing the institution (the injunction was lifted by the United States Court of Appeals for the Sixth Circuit), and subsequently by agreeing to invest approximately $5 million of additional capital into the institution, about $2 million directly from the seven shareholders and an additional $3 million through a public offering. While the additional capital brought Franklin Federal into capital compliance, the public offering drastically diluted the shareholders' ownership rights. Thus, as a result of the government's repudiation of its contract, the seven shareholders of Franklin Financial found themselves sinking significantly more money into the institution than was agreed, and at the same time receiving greatly scaled-back dividends, making it more difficult to recoup their investment. The net result: the government got what it bargained for but those who contracted with the government did not.

D. Benj. Franklin, Which Had Enjoyed 16 Consecutive Profitable Quarters, Was Seized Because The Institution No Longer Satisfied Its Regulatory Capital Requirements After Its Contracted-for Goodwill Was Taken Away.

While Franklin Federal and Charter have survived FIRREA, many other institutions have not been so fortunate. Benj. Franklin is one such institution.

In 1982, at the urging of federal regulators, Benj. Franklin acquired through merger a failing thrift, Equitable Savings and Loan ("Equitable"). Like the Franklin Federal and Charter deals, the government provided no financial consideration but instead agreed that the thrift could treat the inherited deficit as an intangible asset to be amortized over a period of time. The president of the Seattle Federal Home Loan Bank testified that he would not have approved the merger without the 40-year amortization of goodwill because without it "the merger would not have made any sense" since Benj. Franklin would have been rendered insolvent. The parties thereafter negotiated a 40-year amortization period.

In 1986, Benj. Franklin sought the government's approval to go public. The government initially conditioned its approval on Benj. Franklin reducing the 40-year amortization period to only 25 years. After significant negotiations, Benj. Franklin and the FHLBB reached a compromise whereby the amortization period was reduced to 32 years. That the government did not unilaterally impose an abbreviated amortization period on Benj. Franklin reflected the mutual understanding of the parties that the institution had a *contractual* right to treat supervisory goodwill as an asset to be amortized over the contracted-for and agreed-upon number of years. Benj. Franklin thereafter sold $50 million of stock to shareholders who relied upon the balance sheet, which included the goodwill amortization.

Benj. Franklin prospered. As the largest thrift in the Pacific Northwest, its net worth increased from $30 million at the time of the acquisition of Equitable in 1982 to $181 million at the time of the passage of FIRREA in August 1989. At that point in time, Benj. Franklin enjoyed a profit for 16 consecutive calendar quarters and fully complied with all capital regulatory requirements.

Notwithstanding that Benj. Franklin was highly profitable and would have earned its way out of the deficit it inherited, the institution was seized by the government in February, 1990, just six months after the enactment of FIRREA and two months after the implementing regulations became effective. The government, while depriving Benj. Franklin of the consideration for which it had bargained, nonetheless saved approximately $340 million that it would have had to pay to the depositors of Equitable had Benj. Franklin not acquired that institution. The net result: the government got what it bargained for, but those who contracted with the government did not.

E. Landmark's Subsidiary Banks Were Seized Because The Government Abrogated Its Agreement To Calculate Capital In A Manner That Recognized The Fair Market Value Of Land Contributed By Landmark.

Nor is the government's disregard of its contractual obligations limited to "goodwill contracts." Congress, in FIRREA, also prohibited recognition of the *actual value* of real estate contributed, despite contracts requiring such recognition. For example, Landmark, which was a real estate development firm whose stock was listed on the American Stock Exchange and that had no involvement with thrifts, acquired several thrifts from the government in and after 1982. In each instance, Landmark agreed to acquire and contribute real estate to troubled thrifts in consideration for the government's promise that the fair market value of the real estate contributed would

be counted as part of the respective institution's regulatory capital. Had Landmark not acquired these troubled thrifts, the FSLIC would have had to pay huge sums to the depositors of the thrifts.

Upon the passage of FIRREA, the government ordered Landmark to write down the book value of the contributed real estate, even though the real estate was without doubt worth substantially more. As a result of the forced write-down, the thrifts became "insolvent" on an accounting basis. It is undisputed that the real estate had value far greater than its book value.

The government then seized the thrift institutions acquired by Landmark. The Resolution Trust Corporation thereafter sold the real estate contributed by Landmark as part of the thrift acquisition and kept the proceeds. As the sole result of having trusted the Government to live up to its contracts, Landmark went from a highly successful company listed on the American Stock Exchange to an entity with no assets whatsoever. The public stockholders of Landmark found their stock worthless.

As a result of these deals, the government, upon seizing the Landmark subsidiaries, acquired the valuable and substantial real estate contributed by Landmark. Landmark, on the other hand, was left with nothing.

F. All Other *Amici* Acquired Failing Thrifts Pursuant To Similar Contractual Terms.

Likewise, all other *amici* herein (or their predecessors) took part in transactions involving, in substance, comparable fundamental terms. In each case, the government, to avoid substantial liabilities arising from its insurance obligations to the depositors of a failing thrift, offered essentially *financial* consideration or its equivalent to induce either a healthy preexisting thrift or outside investors to acquire or recapitalize the troubled thrift. Though there are variations in the particular forms of the parties' contracts, in substance the deals were the same.

II. THE GOVERNMENT DISTORTS THE FACTS TO AVOID ITS OBLIGATIONS UNDER THE GOODWILL AGREEMENTS.

A. The Transactions In Question Were Binding Contracts.

The government's brief is rife with references to standalone documents, FHLBB resolutions, regulatory approvals and forbearance letters, intimating that the FHLBB references to "amortization periods" and to the "purchase method of accounting" were *unilateral* decisions that did not give rise to or reflect contractual commitments. That issue, however, is not before this Court. While the government explicitly appealed to the Federal Circuit the finding of the Court of Federal Claims that the transactions gave rise to binding contracts, the government has chosen *not* to present that question to this Court. *See* Sup. Ct. R. 14.1(a). Given the government's decision *not* to challenge here that finding, the narrow question before this Court is whether the government can be held liable for breach of these contracts given congressional enactment of legislation allowing the government to accept the benefits of the contracts while precluding the agencies from providing, in return, the bargained-for consideration, *i.e.*, the right to treat supervisory goodwill as a regulatory capital asset to be amortized over an agreed-upon number of years.

Of course, to the extent the *existence* of these contracts is deemed an appropriate question on *certiorari*, this Court need only review the pleadings below to find that the government has not contested that the treatment of goodwill was specifically negotiated by the parties, and further, that in each instance the financial institution provided valuable consideration.

B. The Offer Of Supervisory Goodwill Furthered Important Government Interests.

While the government portrays supervisory goodwill as an accounting "gimmick," it was a device *developed by the government* that produced tangible results. As set forth above, the FSLIC lacked sufficient cash to liquidate failing thrifts and thus turned to healthy thrifts and investor groups to recapitalize failing institutions. Unable to provide tangible assistance to acquiring institutions, however, the FSLIC was unable to induce potential acquirors from going forward. Only by utilizing the purchase method of accounting and giving the acquiror a period of time to absorb the debt of the troubled institution was the government able to avoid the liquidation of hundreds of thrifts, thus saving the insurance fund billions of dollars. For example, Charter's and Franklin Federal's respective successes in turning around the institutions they acquired allowed the government to forego almost-certain liquidations that would have cost the FSLIC more than $70 million. Benj. Franklin's acquisition of Equitable alone saved the government some $340 million in what would have been an extraordinarily expensive liquidation.

While the government asserts in its brief that the idea (*its* idea) of goodwill was ill-advised, the concept of goodwill is hardly novel or suspect. One of the intangible assets recognized by the courts as comprising goodwill is the core deposit base of one financial institution acquired by another financial institution. *See generally Citizens & S. Corp. v. Commissioner*, 91 T.C. 463 (1988), *aff'd*, 919 F.2d 1492 (11th Cir. 1990); *Colorado Nat'l Bankshares, Inc. v. Commissioner*, 60 T.C.M. (CCH) 771 (1990), *aff'd*, 984 F.2d 383 (10th Cir. 1993). These and other cases recognize that:

> the value of the deposit base does not depend upon a vague hope that customers will patronize the bank for some unspecified length of time in the future. The value of the deposit base rests upon the ascertainable probability that inertia will cause depositors to leave their funds on deposit for predictable periods of time.

Colorado Nat'l Bankshares, 60 T.C.M. at 789 (citing Citizens & Southern, 91 T.C. at 499-500).

Financial institutions often buy the core deposits of failed banks separately from other assets. *Citizens & Southern*, 91 T.C. at 498; *Peoples Bancorporation v. Commissioner*, 63 T.C.M. (CCH) 3028, 3029 (1992) ("[d]eposits are sometimes purchased separately from any other assets; the FDIC has done this in resolving insolvencies of troubled banks"); *see also Midlantic Nat'l Bank v. Commissioner*, 46 T.C.M. (CCH) 1464, 1475 (1983) (right to solicit deposits of a failed bank held to be an amortizable and tangible asset). The Commissioner of Internal Revenue has admitted and stipulated that core deposits trade separately in the marketplace. Although the tax laws do not require separate sales to establish that an intangible asset has determinable value separate from goodwill, *Citizens & Southern*, 91 T.C. at 492-93 (discussing *Laird v. United States*, 556 F.2d 1224, 1233-34 (5th Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978); *KFOX, Inc. v. United States*, 510 F.2d 1365 (Ct. Cl. 1975)), there could be no clearer proof of the separate and unique value of core deposits than the fact that financial institutions frequently can and do buy core deposits independently of other assets.

C. Congress Approved Regulators' Use Of Supervisory Goodwill In Contracts With Financial Institutions.

Nor can the government legitimately suggest that Congress did not know of, approve or sanction the regulators' use of supervisory goodwill to induce healthy thrifts and investor groups to acquire troubled thrifts. Congress recognized the inability of the FSLIC to solve the problems on its own and gave the FSLIC a variety of tools to attract

new investors to insolvent thrifts.* In fact, Congress explicitly recognized the importance of the concept of supervisory goodwill in 1987 when it modified the National Housing Act to provide:

> No provision of this section shall affect the authority of the Corporation [(the FSLIC)] to authorize insured institutions to utilize subordinated debt and goodwill in meeting reserve and other regulatory requirements.

12 U.S.C. § 1730h(d) (repealed 1989). Congress thus not only sanctioned the practice of offering acquiring institutions the right to treat the assumed debt as supervisory goodwill, but also confirmed the FSLIC's authority to continue that practice.

D. A Governmental "Right" To Abrogate Contractual Commitments Is Inequitable And Would Wreak Havoc On Government Contracts.

In its attempt to avoid its obligations under the goodwill agreements, the government distorts the facts by mischaracterizing the acquiring thrifts and investment groups as opportunistic gamblers who sought a risky benefit from these goodwill agreements. Brief for Appellant at 2 ("thrifts frequently sought to increase the size of their loan portfolios, thus putting even more of their depositors' money at risk"). The government contends that the thrift industry, being highly regulated, "risk[ed] that this regu-

* The government makes much of the fact that the contracts of the *Winstar* plaintiffs were with the FSLIC rather than with the FHLBB. Of course, the FHLBB agreed to the contracts and entered into contracts implied-in-fact with plaintiffs when it passed its resolutions as part of the transactions. Congress authorized the FSLIC to enter into contracts and specifically granted the FSLIC the power to approve "Emergency Thrift Acquisitions" on "such terms as the Corporation shall provide." 12 U.S.C. § 1730a(m)(1)(A)(ii) (repealed 1989). The term "Corporation" meant the FSLIC. *Id.* § 1725(a).

latory policy [permitting the amortization of supervisory goodwill] might change in the future." *Id.* at 27.

Respondents do not contest the unremarkable proposition that regulated entities are always subject to some risk that the regulatory regime under which they operate may change. This case, however, is not about a right arising under a regulation. Rather, this case is about a *contractual* right, specifically negotiated and for which valuable consideration was provided. Under these circumstances, the thrifts cannot be said to have assumed the risk that their bargained-for rights may be eliminated, with impunity, by legislative or regulatory fiat. The government is simply wrong when it asserts that it may execute contracts devoid of any risk, secure in its knowledge that it may breach its contractual obligations with impunity should it, in its subjective opinion, find the contract inadvisable or its terms inconvenient.

If the government's argument were to be believed, then, for example, Congress could have enacted FIRREA *one day* after any of these transactions, seized the institution (if exclusion of the promised-for supervisory goodwill rendered the institution in noncompliance with the capital requirements) and taken the capital contributed by the acquiror, thus leaving the acquiror with nothing. According to the government, it simply makes no difference that the acquiror would not have received any of the promised benefits or that the government would have walked off with the acquiror's infusion of capital.

If the government were to enjoy the right to avoid its contract obligations with impunity, as it claims, the government would find it nearly impossible to raise private capital in the industry. Indeed, while everyone may agree that "private capital is the taxpayer's cushion . . . , ultimately reducing the bailout's cost to taxpayers," the regulators' unusual way of saying "thank you" to institutions

like *amici* only serves to scare off potential new investors and much needed private capital. *See* Leslie Wayne, *Investors Decline Government Deals For Failed S&L's*, N.Y. TIMES, Nov. 14, 1990 at A1. Investors, knowledgeable of the regulators' treatment of recapitalized thrifts, are wary of dealing with the government, recognizing that "the contract[s] you negotiate could be upset if the political winds change." *Id.* In fact, after the government began seizing the very institutions it induced to acquire the troubled thrifts the government could not afford to liquidate, private capital dried up because investors "do not trust the Government as a business partner." *Id.* All of this raises the simple question: if the government today can abrogate at will its contracts of yesterday, who tomorrow will be willing to assume the risk of dealing with the government in times of crisis?

Furthermore, if the government cannot be held to its word, it is merely a matter of time before those who contract with the government (in any industry) will conclude that the government is an unaccountable, unreliable business partner, thus causing the inevitable decline in competition for government contracts. Chief Judge Loren Smith in *Winstar Corp. v. United States*, 25 Cl. Ct. 541 (1992), acknowledging this eventuality, wrote:

> While the government may engage in extremely large and important contractual relationships, it would make all dealings with the government a very elaborate and expensive form of gambling to hold that the government may repudiate a contract whenever subsequent policy considerations dictate that it was not a good or prudent bargain.

Id. at 548. The increased risks in contracting with an entity that may abrogate its contracts tomorrow (or whenever the political winds change) without penalty inevitably would result in inflated government contract bids (which must be adjusted to account for this risk) and greater

government skepticism. That has never been the law, and this Court should decline to accept so radical a shift in the relationship between the government and private parties.

CONCLUSION

For the foregoing reasons and for the reasons set forth in the other briefs filed in support of the Respondents, *amici* urge that the decision of the Federal Circuit *en banc* be affirmed.

Respectfully submitted,

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